

FAQs - Imputed Income for Term Life Insurance



What is imputed income?

The IRS requires you to be taxed on the value of employer-provided group term life insurance over \$50,000. The taxable value of this life insurance coverage is called "imputed income." Even though you don't receive cash, you are taxed as if you received cash in an amount equal to the value of this coverage.

Why is pre-tax Term Life insurance subject to the imputed income rules?

Because your monthly premium for group term life insurance coverage is deducted from your pay on a pre-tax basis, the IRS considers it to be "employer provided." Therefore, the value of any pre-tax (and other employer-provided) coverage over \$50,000 is added to your taxable compensation as "imputed income."

What am I paying tax on?

The Retirement System death benefit and the NCFlex group term life insurance benefit are added together. The amount which can be provided tax-free (\$50,000) is subtracted from this amount. You pay taxes on the amount of term life coverage over \$50,000. You can estimate your imputed income, which is subject to taxation, by using the [Imputed Income Calculator](#).

What happens if I am not yet eligible for the Retirement System death benefit because I do not have one year of service under the Retirement System?

Once you become eligible for the Retirement System death benefit, that benefit will be added to your total term life benefit when calculating the amount of your imputed income. Until then, only your NCFlex group term life benefit will be included in this calculation. (For example, if you are not yet eligible for the Retirement System death benefit and your NCFlex group term life benefit is less than \$50,000, you will not have any imputed income.)

When am I taxed?

Your pre-tax premium deduction for the term life benefit comes out of your check each payday. Also, any taxable imputed income resulting from your "employer-provided" pre-tax coverage is added back at the same time. Generally, however, many employees will experience a "tax wash." This means the savings employees would receive by purchasing their term life insurance coverage on a pre-tax basis is roughly the same amount of tax on the imputed income added to their pay.

Example

Joanne Smith is age 35, makes \$30,000 a year and has a Retirement System death benefit of \$30,000. She has elected \$40,000 of NCFlex term life insurance.

Total death benefit: \$70,000

Excess amount over \$50,000: \$20,000

NCFlex rate imputed income: \$3.88 ($\$40,000 / \$1,000 = 40 \times \0.097)

In this example, \$1.80 will be added to the employee's monthly pay and is subject to federal, FICA, and North Carolina income tax. In general, because this coverage was paid for on a pre-tax basis, most employees will experience a "tax wash," meaning that you would pay almost the same amount in taxes had the life insurance coverage been paid on an after-tax basis (i.e., after federal, FICA, and North Carolina taxes had been deducted from your pay). However, individual results may vary. For example, where the IRS estimate of the market value of your group term life benefit, as expressed in Table I, exceeds your NCFlex premium rate, you are taxed on the difference as if you received an employer-provided subsidy. In every case, participating employees receive the advantage of the competitive rates and guaranteed issue of the NCFlex plan.

Am I being taxed twice?

No. Imputed income is taxed once and that is each payday. At the end of the year, your Form W-2 will include your taxable income (including imputed income) as well as the amount of taxes that have been taken out throughout the year.

Why am I taxed for a death benefit that I may never use?

The death benefit provided under the State Retirement System is a valuable benefit for your family in the event of your death. Since the State provides this benefit to you (rather than you having to pay for it on your own) the IRS treats it as taxable income just like your pay.

What is the long-term effect on my retirement benefit?

Participation in the term life plan will not affect your benefit under the Retirement System. In addition, it will not affect the amount you may contribute to the State's 401(k) plan or to a 403(b) or 457 retirement plan.

Plan participation may affect your future Social Security retirement benefits. This could happen if your taxable pay (after pre-tax contributions are taken out) is below the Social Security taxable wage base (\$106,800 for 2010). For most employees, the immediate tax savings is a far greater benefit than the long-term impact on Social Security benefits.

What is the advantage of buying term life insurance from NCFlex?

There are several advantages. First, the premiums are very competitive. Second, there is \$100,000 of guaranteed issue when you first become eligible. Third, the benefit is portable so you can take it with you if you transfer from one State agency/university to another or if you terminate employment or retire before age 70. Fourth, there are other valuable features such as waiver of premium and an accelerated death benefit. Details on these benefits are described in the [2011 BEACON Enroll Guide](#) or [2011 Hewitt Enroll Guide](#).

